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Report on
Floating Charges on Land

LAW REFORM COMMISSION OF BRITISH COLUMBIA

MINISTRY OF ATTORNEY GENERAL

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LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON FLOATING CHARGES ON LAND

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TO THE HONOURABLE S.D. SMITH, Q.C.
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA:

The Law Reform Commission of British Columbia has the honour to present the following:

REPORT
ON
FLOATING CHARGES
ON LAND

Floating charges on land serve a limited but, nonetheless, useful function in commercial financing. It is therefore necessary to ensure that they are accommodated within the schemes for registering security interests against various types of property.

In the near future, adoption of a *Personal Property Security Act* will substantially alter the way in which corporate security interests are registered. At that time, floating charges on land, as a security device, will be jeopardized unless steps are taken to create a new scheme for registering uncrystallized charges. An independent reason for undertaking reform is that a number of problems exist under the current regime for registering floating charges on land.

The scheme recommended in this Report provides a simple but effective way of meeting the needs of those who use floating charges on land as a tool in structuring commercial loans.

CHAPTER I INTRODUCTION

A. General

Usually, when a debtor becomes insolvent, very few assets are left for distribution among ordinary creditors after secured creditors and governments have asserted their rights to a prior share of the debtor's property. A lender may lift himself out of the class of ordinary creditors by acquiring the right to satisfy his claim out of particular items of the debtor's property, to the exclusion of all other creditors. This right is called a security interest in the property.

The floating charge is a particular kind of security interest. Analytically, it is a type of mortgage but it functions in quite a different fashion. The characteristic which distinguishes it from the conventional "fixed "mortgage is that, so long as the debtor (almost always a company when a floating charge is involved) remains financially healthy, the floating charge does not bind specific assets. It merely floats or hovers[1] over the assets covered by it.[2] The debtor remains free to dispose of assets in the ordinary course of its business.[3]

If, however, specified events (usually associated with financial difficulty on the part of the debtor) occur, the creditor is able to reinforce his position by causing the floating charge to become fixed on particular assets. This process is called "crystallization." On crystallization, the floating charge ceases to hover; it descends and fastens upon whatever applicable assets the debtor owns at that time. The creditor's previ-

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1. *In re Woodroffes (Musical Instruments) Ltd.*, [1986] 1 Ch. 366, 378 *per* Nourse J.

2. A floating charge may cover all of a debtor's assets, or only part of them. The courts have never provided an exhaustive definition of the floating charge: *In re Brightlife Ltd.*, [1987] 2 W.L.R. 197, 205 *per* Hoffmann J. (Ch. D) and *In re Yorkshire Woolcombers Association Ltd.*, [1903] 2 Ch. 284, 295 *per* Romer L.J. (*aff'd, sub nom Illingsworth* v. *Houldsworth*, [1904] A.C. 355 (H.L.)). In determining whether a document creates a specific or floating charge, the use of the term "specific charge" is not conclusive; in each case the overall intent is the critical factor: *R. in Right of British Columbia* v. *Federal Business Development Bank*, (1987) 17 B.C.L.R. (2d) 273, 311 *per* McLachlin J.A. and 315 *per* Wallace J.A. and *In re Brightlife, supra*, at 201 *per* Hoffmann J.

3. In contrast, a fixed mortgage binds specific property until the debt is paid off. It therefore prevents the debtor from selling or otherwise transferring clear title to the property unless he first takes steps to remove the mortgage; see *R. in Right of British Columbia* v. *Federal Business Development Bank*, *ibid.* The general freedom of a debtor to dispose of assets in the ordinary course of business is usually treated as an essential characteristic of a floating charge: *Illingsworth*, *ibid.*, at 357 *per* Earl of Halsbury L.C.; *see also R. in Right of British Columbia* v. *Federal Business Development Bank*, *ibid.*

ously floating charge becomes a fixed equitable mortgage on those assets.[4]

The floating charge first emerged as an inventory financing device. It enabled a corporate trader to grant security over its stock-in-trade.[5] A secondary role soon emerged however. The floating charge permits a lender to take security against all a debtor's assets. The charge can cover permanent assets (whether land or chattels) and all other assets presently owned by the borrower or which the borrower may acquire in the future. This broadly based security provides protection should the borrower become insolvent. The holder of a floating charge is entitled to look to the assets covered by the charge in priority to the trustee in bankruptcy, who (for practical purposes) represents the general unsecured creditors of the insolvent company.

Our decision to undertake a review of floating charges on land was prompted, in part, by a change which will soon occur with respect to the machinery for the registration of these charges. Currently, a floating charge, whether it covers land, personal property, or both, can be registered at the Office of the Registrar of Companies in the register of corporate mortgages.[6] It appears, however that a new *Personal Property Security Act* will be enacted and brought into force in the near future.[7] This new legislation contemplates the abolition of the register of corporate mortgages. Floating charges, so far as they extend to personal property, will be registrable under the new legislation but, to the extent that such charges cover land, they will be orphans. For reasons set out below, it

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4. *Andrekson* v. *Peerless Pipe & Equipment (1971) Ltd. et al.*, (1982) 38 B.C.L.R. 381, 384 *per* Carrothers J.A.

5. An important characteristic of inventory is that individual items of merchandise continually change. A fixed mortgage over inventory is clearly impractical since it would have to be amended each time the company bought or sold any goods. In order to meet this commercial need, the courts developed the concept of the floating charge. *See In re Panama, New Zealand, and Australian Royal Mail Company*, (1870) L.R. 5 Ch. Ap. 318; and *In re Colonial Trusts Corporation*, (1879) 15 Ch. D. 465, 472 *per* Jessel M.R. For a discussion of the history and also the original commercial pressures giving rise to the floating charge, *see* G.F. Curtis, "The Theory of the Floating Charge," (1941-42) 4 University of Toronto Law Journal 131 and Robert R. Pennington, "The Genesis of the Floating Charge" (1960) 23 Modern Law Review 630; *see also In re Brightlife Ltd.*, *supra*, n. 2 at 206 *per* Hoffmann J.

6. *Company Act*, R.S.B.C. 1979, c. 59, s. 75. A floating charge can also be registered under the *Land Title Act*, R.S.B.C. 1979, c. 219, against specific parcels of land. A fuller discussion of the registration of floating charges on land is contained in the next chapter. One of the underlying reasons for these registration schemes is to prevent creditors (or other persons dealing with a debtor) from being prejudiced by prior but unrevealed charges against the debtor's property.

7. A draft *Personal Property Security Act* was released by the provincial government in April 1988. Extracts of the Act relevant to this Report are reproduced in Appendix B.

is necessary to ensure that appropriate machinery for the registration of floating charges on land is in place.[8]

B. Methodology

It was felt by the Commission that informed advice on this topic was best achieved by constituting an advisory committee of experts, rather than by following the Commission's usual practice of consulting through the publication of a working paper. The course of action in this project is similar to that which led to our *Report on Defamation*.[9] In the fall of 1986, the Commission constituted an Advisory Committee on Floating Charges on Land. This Committee was chaired by Professor Terry Wuester of the Faculty of Law at the University of Victoria. Other members of the Committee included a Justice of the Supreme Court, the Director of Land Titles, a banker and a number of lawyers practising in business and commercial law.[10] The Commission is fortunate that such a group of knowledgeable and uniquely qualified individuals agreed to serve on the Committee.

The Committee presented its report to the Commission in the fall of 1987. After careful consideration, we have decided to adopt the general scheme recommended by the Committee. Given the experience and expertise brought by the members to the work of the Committee, the Commission concluded that it would be appropriate to proceed directly to a final report.

C. The Need for Flexible Security Over Land

Floating charges on land are not a commonly relied upon form of security. A preliminary question therefore is whether

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8. In its 1975 *Report on Debtor-Creditor Relationships, Part V - Personal Property Security* (LRC 23), the Commission recommended that the registration of corporate mortgages under the *Company Act* should be abolished when a *Personal Property Security Act* came into force. The reasons for that recommendation are set out at pp. 135-136 of the 1975 Report. It was the conclusion of our consultants that there would be no need to retain the register of corporate mortgages under the *Company Act* after the enactment of a *Personal Property Security Act*. It has subsequently become apparent that floating charges on land are a corporate security for which there would be no adequate registry after the abolition of the register of corporate mortgages at the Office of the Registrar of Companies; *cf. Daon Development Corporation* v. *National Trust Company Ltd.*, (1982) 39 B.C.L.R. 341 (S.C.). (Floating charges on personal property will be dealt with as a security interest under the *Personal Property Security Act* when that Act comes into force.)

9. LRC 83, 1985.

10. A full list of the members of the Advisory Committee is contained in Appendix E.

they in fact perform a useful function in modern commerce. The Advisory Committee made the following comments:

> The floating charge originally developed as a device for taking security over a fluctuating inventory of chattels. It is clear, however, that floating charges also have a useful, if limited, function as a security device over land.
>
> Where security for a loan is to consist of land, a creditor usually takes a specific mortgage over land owned by the debtor at the time of the loan. Depending upon the arrangements between the lender and borrower, the latter may also grant a fixed mortgage over other land as it is acquired in the future. A lender does not normally rely on a floating charge on land as his primary security. The floating charge is not a strong form of security since it may lose priority to a variety of later charges on the land.
>
> There are situations, however, where a floating charge may be a very important part of the lender's security. Where a developer is dealing with large amounts of land, the floating charge is sometimes the most useful form of security [*e.g.*, *Daon Developments Corporation v. National Trust Company Ltd.*, (1982) 39 B.C.L.R. 341 (S.C.)]. If a lender's primary concern is to safeguard his position against a trustee in bankruptcy, a floating charge is an appropriate security device. It provides the protection desired by the creditor, yet leaves the developer free to buy and sell land without the need to obtain a temporary mortgage (and eventually a discharge of that mortgage) for each piece of land. The preparation and discharge of separate mortgages involves the expenditure of time and legal fees. The lending community may also use floating charges on land where the borrower is a very small developer.

The Committee concluded that there was a need for a security device which, like the floating charge, permits the rational treatment of land as inventory. We agree.

D. The Future of the Floating Charge

The floating charge over land, as it is currently used, conforms very much to the judge-made security developed by the courts of equity a century ago. The same could also be said, at least until very recently, about the way analogous security is taken over personal property. But security arrangements involving personal property are undergoing a change and it is not improbable that developments in this area may spill over into security over land. A question we have had to confront is how far we should fashion our recommendations to accommodate changes in financing patterns, the nature and extent of which have not yet clearly emerged.

The developments which have occurred with respect to security in personal property arise out of the flexibility that new personal property security legislation gives financers in taking security. In particular, an agreement in which the debtor gives his creditor a security interest in "all my present and after-acquired personal property" would provide all the protection of a floating charge and more. This formulation creates a fixed charge so the vagaries of crystallization do not arise. Moreover, it is conceptually simpler than a floating charge. This kind of formulation has become the norm in the United States[11] and is gradually being adopted by financers in those provinces with modern personal property security legislation. Some commentators suggest that the use of the floating charge as a general security device may wither and die.

E. The Scope of Reform

To what extent should these current and potential developments be taken into account in formulating reform proposals? The threshold question we faced was whether the floating charge on land, *per se*, should be given some particular status in legislation. We were somewhat apprehensive about tying a reform measure into a security device that seemed to be waning in popularity. An alternative might be to develop some form of statutory security to satisfy the need currently met by the floating charge on land. We put this question to our Advisory Committee. They rejected the notion of a statutory form of "non-specific charge" on land and recommended that any reform measure should accommodate the floating charge as currently used.

We accepted the Committee's view and this led us to the second question. Should our reform measures be confined to the floating charge or should they also extend to security created by charging language such as "all my present and after-acquired land?" The latter formulation does not, at the present time, seem to be in general use but it may gain popularity as its personal property analogue becomes more widely adopted. This second question gave us a good deal of diffi-

11. The common law floating charge was never a part of American law so this was a reasonable approach to adopt when the enactment of Article 9 of the *Uniform Commercial Code* made it possible to take effective security of this kind.

culty. It was our ultimate conclusion that reform should be confined to the conventional floating charge.

There were two principal reasons for this conclusion. First, the coming of personal property security reform means that financers and their legal advisors will have to become familiar with a good deal of new law. This suggested to us that there would be considerable virtue in keeping our own scheme as simple as possible to minimize "reform overload" in the area of security interests. Second, the Advisory Committee's recommendations were directed at floating charges only, and an extension of the scheme to the second type of security agreement raises conceptual difficulties surrounding the role of crystallization.

While we firmly believe that the recommendations contained in this Report should be implemented without delay, given the narrow focus of our attention in this project, it is also our belief that this whole topic should be re-examined at some future time, say in 10 or 15 years. This would permit a more accurate assessment of the impact of the *Personal Property Security Act* on commercial financing generally, and on the floating charge as a security device. The provisions in place at that time could then be fine-tuned or replaced as circumstances require.

F. This Report

Chapter II of this Report examines the problems and uncertainties surrounding the use of floating charges on land. Chapter III then sets out recommendations for reform, in general terms. Draft legislation implementing the recommendations is contained in Chapter IV.

CHAPTER II THE NEED FOR REFORM

A. Introduction

The factors which suggest that there is a need to revise and clarify certain aspects of the law concerning floating charges on land can be summed up in two concerns about the registration of such charges. First, there is the difficulty which will flow from the abolition of the register of corporate mortgages at the Office of the Registrar of Companies when a *Personal Property Security Act* comes into force.[1] Second, significant uncertainty surrounds the degree of protection which the current law confers on the holder of a floating charge on land -- a reflection of a not entirely happy marriage of common law and statutory rules.

B. Overview of the Current Law

1. Common Law

An uncrystallized floating charge floats or hovers over the debtor's assets. For most practical purposes, the charge is dormant, in the sense that the rights of a person who acquires an interest in particular property are not affected by it.[2] Upon crystallization, a floating charge affixes to the assets owned by the debtor at that time. The fixed security received by the holder of a charge therefore depends upon the extent of the debtor's beneficial interest in assets at the date of crystallization.

2. Land Title Registration

British Columbia's system of land registration provides a public register of title to land. The register serves to identi-

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1. *Supra*, Chapter I, n. 7.
2. Before crystallization, the charge may provide limited protection where the debtor transfers or charges assets outside the ordinary course of its business and where the floating charge contains a negative covenant known to a person taking an interest in the property. This type of covenant (also called a negative pledge) prohibits the debtor from granting a subsequent mortgage, or other security interest, with priority over the floating charge. If a subsequent mortgagee or chargee has notice of such a covenant, the floating charge (once it has crystallized) takes priority over the later interest: *Union Bank of Halifax* v. *Indian and General Investment Trust*, (1908) 40 S.C.R. 510; *Wilson* v. *Kelland*, [1910] 2 Ch. 306. *Canadian Imperial Bank of Commerce* v. *Beau Industries et al.*, (unreported), February 21, 1984, S.C.B.C Vancouver Reg. No. C824851. *See also Lloyds Bank of Canada* v. *Lumberton Mills Ltd.*, (as yet unreported) November 8, 1988, B.C.C.A. Vancouver Reg. No. CA007952, p. 20 *per* Esson J.A.

fy the owner of, and persons who have a security or other interest in, a specific parcel of land. Section 20(1) of the *Land Title Act*[3] provides a succinct statement of the principle which underlies the system:

> **20.** (1) Except as against the person making it, no instrument purporting to transfer, charge, deal with or affect land or an estate or interest in it is operative to pass an estate or interest, either at law or in equity, in the land unless the instrument is registered in compliance with this Act.

This provision is reinforced by section 22, which states that an instrument dealing with land is effective only from the date of registration under the *Land Title Act*:

> **22.** Every instrument purporting to transfer, charge, deal with or affect land or an estate or interest in it shall pass the estate or interest either at law or in equity created or covered by the instrument at the time of its registration, irrespective of the date of its execution.

These two provisions form the core of our system of land title registration.[4] The holder of a charge on land is protected against third parties only after he registers his charge against the land.

3. Registration Under The Company Act

In addition to the registration requirements imposed by the *Land Title Act*, where the borrower is a corporation (as it invariably is when a floating charge is given as security), certain provisions of the *Company Act*[5] are also applicable. Section 75 of the Act requires that a mortgage (including a floating charge) given by a company must be registered at the Office of the Registrar of Companies. The registration of a floating charge with the Registrar of Companies assures the chargeholder that his interest will be recognized by a trustee in bankruptcy of the debtor.[6] But if the floating charge is registered only with the Registrar of Companies, it receives no protection against any other third party who registers an interest under the *Land Title Act*.

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3. R.S.B.C. 1979, c. 219. The Act provides a modified Torrens system of land title registration.
4. Other important provisions giving effect to the principles set out in sections 20 and 22 include sections 23, 26, 28 and 29. These provisions are reproduced in Appendix A of this Report.
5. R.S.B.C. 1979, c. 59. Section 75 and 79 are reproduced in Appendix A of this Report.
6. *Bankruptcy Act*, R.S.C. 1985, c. B-3, s. 75 (reproduced in Appendix A); *Daon Development Corporation* v. *National Trust Company Ltd.*, (1982) 39 B.C.L.R. 341 (S.C.).

C. Current and Future Difficulties

The interest created by an uncrystallized floating charge on land is not one which fits comfortably within our system of land registration. Currently, an uncrystallized floating charge may be registered against a specific parcel of land.[7] This registration can, however, be a source of difficulty. As the Advisory Committee noted:[8]

> An important (and perhaps crucial) feature of a floating charge is that it allows a debtor to continue dealing with assets, but only in the ordinary course of business. What should happen when a debtor seeks to convey a parcel of land against which there is a registered floating charge? Should the registrar of land title disregard the floating charge and issue to the transferee a certificate of indefeasible title free of the floating charge? What should happen if the conveyance was out of the ordinary course of the debtor's business? What should be the result if the charge had crystallized before application was made to register the conveyance? A registrar of land title does not have a simple mechanism by which he can satisfy himself that the transferee is entitled to receive clear title to the land.

This problem is one example of an undesirable side effect of registering an uncrystallized floating charge at a land title office. The mere registration of a floating charge against a parcel of land does not, strictly speaking, convert the charge into a specific or fixed one. It, nonetheless, has the practical effect of creating a fixed charge and restricts the debtor's freedom to deal freely with its land. Before registering clear title to a transferee, the registrar of land title will first require that the floating charge be discharged by the person holding

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7. *In Re The Land Registry Act*, (1904) 10 B.C.L.R. 370 (Full Court); Ministry of Attorney General, *Land Title Practice Manual* (Victoria, 1980) 299-300 and 1164-1165.

8. *See* n. 3 in Chapter I for cases concerning floating charges and the general freedom of a debtor to dispose of assets in the ordinary course of business. On the issue of whether the registration of an uncrystallized floating charge against a specific parcel of land creates a fixed charge, the Advisory Committee referred to the following *dicta* by Nitikman J. in *Schneeberger* v. *Quality Woodwork Co. Ltd.*, (1965) 54 W.W.R. 321, 328 (Man. Q.B.):

> Registration [at a land title office] would immediately have converted it [*i.e.*, the floating charge] into a specific charge and prevented the free dealing of the land by the company, *contrary to the nature and intent of the floating charge*. [emphasis added]

The Committee went on, however, to note that, although Nitikman J. was correct in his comments about the practical effect of registering an uncrystallized floating charge at a land title office, his *dicta* on the legal effect, and perhaps the impossibility, of such a registration do not appear to reflect the law in British Columbia: *see supra*, n. 7. The Alberta Court of Queen's Bench has recently held that, under the Alberta *Land Titles Act*, the registration of a floating charge debenture against a parcel of land creates a fixed charge (which takes priority over a subsequently registered fixed mortgage): *Canadian Imperial Bank of Commerce* v. *W.G. Fahlman Ent. Ltd.*, (1987) 56 Alta. L.R. 353, 357 *per* Trussler J. In reaching this conclusion, the Court inexplicably relied upon a Manitoba decision involving a debenture which expressly created "a fixed and specific mortgage and charge" on a particular parcel of land: *Re Manitoba Development Corp. and District Registrar of Winnipeg Land Titles Office*, (1983) 149 D.L.R. (3d) 181 (Man. Q.B.).

it. This interference with the ability of a debtor to deal freely with its land was a major concern to the Committee.

The restrictions which the registration of an uncrystallized floating charge against a specific parcel of land may place on a debtor's ability to deal with the land seem inconsistent with the nature of this type of security. We believe that the concerns of the Advisory Committee are well-founded.

Other difficulties concern the priority between a floating charge and a subsequent charge, such as a mortgage, registered against land owned by the debtor. A variety of problems can occur. For example, what are the rights of the parties when the registration of a floating charge is followed by the registration of a fixed mortgage against the same parcel of land, and the floating charge is subsequently crystallized? Section 28 of the *Land Title Act* states the rule for determining the priority between competing charges registered against land:

> **28.** When 2 or more charges appear entered on the register affecting the same land, the charges have, as between themselves, *but subject to a contrary intention appearing from the instruments creating the charges*, priority according to the date and time the respective applications for registration of the charges were received by the registrar, and not according to the respective dates of execution of the instruments. [emphasis added]

Does this provision mean that the floating charge has priority over the fixed mortgage even though the floating charge crystallized after the mortgage was registered?[9] Such an outcome would be contrary to the result at common law[10] and perhaps also to the expectations of the parties. It could be argued that an instrument which creates a charge not intended to bind any specific assets until crystallization may show a "contrary intention" sufficient to take the priority issue out of the general rule stated in section 28. One is left, however, with the conclusion that there appears to be no clear answer to this particular priority problem.

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9. The answer would be yes if *Schneeberger and Canadian Imperial Bank of Commerce* accurately reflect the law in British Columbia. But *see* the discussion, *ibid.*, of these two cases.

10. Since a floating charge does not affix to any specific assets until it has crystallized, the common law gives priority to a specific mortgage granted after the floating charge but prior to its crystallization; *see National Trust Company Ltd.* v. *Bank of Montreal et al.*, (1984) 59 B.C.L.R. 112, 119 *per* Esson J.A. (dissenting on another issue) and *Canadian Commercial Bank* v. *Canadian Imperial Bank of Commerce*, [1988] 3 W.W.R. 607 (B.C.C.A.).

The dearth of cases dealing with this kind of priority problem might suggest that priority issues should not be a source of concern. The lack of cases, however, probably reflects nothing other than prudence on the part of lenders who take security where a floating charge already exists. We believe it would be desirable to remove this source of uncertainty.

A final difficulty exists independently of the problems caused by the ill-defined relationship of the land registration system and the common law on floating charges. As previously noted, the enactment of a new *Personal Property Security Act*[11] contemplates the abolition of the register of corporate mortgages established under the *Company Act*.[12] If that occurs, the only option available to the holder of a floating charge on land, who wishes to ensure that his security is recognized should the borrower become bankrupt, would be to register the floating charge against specific parcels of land owned by the borrower.

The registration at a land title office of an uncrystallized floating charge is a comparatively rare occurrence at the present time. If, however, this were the only way to register these charges, a proliferation of such registrations could be expected to occur, with all the undesirable results described above.[13] This lends urgency to the task of ensuring there is appropriate machinery to accommodate the registration of uncrystallized floating charges.

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11. *Supra*, n. 1.
12. *See* ss. 75 and 82.
13. There is the additional problem that a floating charge registered only against specific parcels of land does not protect the secured party with respect to land subsequently acquired by the debtor unless the secured party registers it against each new parcel of land as it is acquired.

CHAPTER III RECOMMENDATIONS FOR REFORM

A. Introduction

There is an undoubted need to provide a new statutory framework within which the law governing floating charges on land can operate. We have, with a few minor modifications, adopted the scheme recommended to us by the Advisory Committee. This scheme deals with floating charges in two separate stages: before crystallization and after crystallization.[1] It is described in general terms in this chapter and in Chapter IV the scheme is restated in the form of draft legislation.

B. Before Crystallization

Because the registration of an uncrystallized floating charge against a parcel of land interferes with the debtor's ability to deal with that land, such registration should clearly be prohibited by the *Land Title Act*.[2] Although it would not be registrable in a Land Title Office, an uncrystallized floating charge must be registered somewhere if it is to maintain priority against a trustee in bankruptcy.[3] The Advisory Committee recommended that uncrystallized charges be registered either at the Personal Property Registry which will be created under the *Personal Property Security Act*[4] or at a new register at the Office of the Registrar of Companies specially created for this purpose.

We believe that the Personal Property Registry is the more appropriate location.[5] Nearly all floating charges on land also cover personal property and registration at the Per-

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1. A variety of possible approaches were considered by the Advisory Committee. Schemes considered but rejected by the Committee included the creation of a statutory non-specific charge on land, retention of the common law floating charge coupled with a statutory form for its creation, and the creation of a Floating Charge Register (similar to the former Judgment Register) in the land title system.
2. One suggestion considered by the Advisory Committee was that the holder of an uncrystallized floating charge should continue to be able to register the charge against land, but that registrars of land title be statutorily empowered to effect a transfer of the land free and clear of the registered floating charge as long as the holder of the charge had not filed a formal notice of crystallization. This proposal was rejected by the Committee since it would leave unresolved most of the existing uncertainty concerning priorities between an uncrystallized floating charge registered on title and other registered interests in the land.
3. *Bankruptcy Act*, R.S.C. 1985, c. B-3, s. 75 (reproduced in Appendix A).
4. *See* s. 42 (reproduced in Appendix B).
5. S. 42(1) of the draft *Personal Property Security Act* (reproduced in Appendix B) contemplates use of the Personal Property Registry under other statutes.

sonal Property Registry will occur in any event. Thus it would be possible to permit a single registration to cover both land and personal property. This would avoid needless duplication and give the user true "one stop shopping." This very real practical advantage of using the Personal Property Registry outweighs any conceptual concerns that might arise about utilizing a personal property registry to register an interest affecting land.

Before crystallization, the only third parties who would be affected by a floating charge registered at the Personal Property Registry would be a trustee in bankruptcy and the holder of a competing floating charge. These persons would search the Personal Property Registry quite apart from any desire to find out whether there was a floating charge registered against land owned by the debtor.[6] Other persons obtaining a transfer of the land or a fixed security interest in the land would be unaffected by a floating charge registered at the Personal Property Registry and would have no need to check it.

C. After Crystallization

1. General

Once a floating charge has crystallized, the holder of the charge should then be able to register it against specific parcels of land owned by the debtor.[7] In doing so, he will obtain the protection afforded to charge holders by the *Land Title Act*.[8] More specifically, his charge will be subject to interests already registered against the land but will take priority over any subsequently registered interests.

Most floating charges on land are created in security instruments of considerable length. Rather than requiring that the original, or a certified, copy of the instrument be actually registered in each land title district in which the debtor has land, it seems more appropriate merely to register a notice of

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6. If they wished to see a security instrument notice of which has been registered at the Personal Property Registry, they would be able to do so; *see* s. 18 of the *Personal Property Security Act* (reproduced in Appendix B) and subsection (10)(c) of the draft legislation in Chapter IV.

7. Upon crystallization, the charge becomes a fixed equitable mortgage: *Andrekson v. Peerless Pipe & Equipment (1971) Ltd. et al.*, (1982) 38 B.C.L.R. 381, 384 *per* Carrothers J.A.

8. In particular, *see* s. 28 (reproduced in Appendix A).

the crystallized charge. This would reduce the load on the facilities for preserving documents in the land title system.[9]

2. Competing Floating Charges

The Advisory Committee was concerned that the general priority rule (date of registration) under the *Land Title Act*[10] would have an undesirable result in a contest between two competing floating charges. At common law, the priority between competing floating charges is determined by their respective dates of execution.[11] This means that a second floating charge does not gain priority over the earlier charge merely because it crystallizes before the first charge.[12] The holder of the first floating charge is thus protected against a subsequent floating charge granted by the debtor. The Advisory Committee felt that it was important to preserve this protection.

This can only be achieved, however, if priority between competing floating charges on land which have already crystallized is not determined by the dates when the charges were registered against the land. A different priority rule is called for. The Advisory Committee concluded, and we agree, that as between two crystallized floating charges, priority should be determined by the dates on which the uncrystallized charges were registered at the Personal Property Registry.[13]

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9. Under the draft legislation, there is power to make regulations governing the procedure for applying to register a notice of a crystallized floating charge. If it is felt necessary that a registrar inspect the instrument creating a floating charge before a notice of the crystallized charge is registered (*cf.* s. 193 of the *Land Title Act*), a regulation could require that a person applying to register a notice of a crystallized floating charge must supply a copy of the instrument for inspection by the registrar.

This use of a notice is similar, in many respects, to the use of a caveat in the prairie provinces and to a registrar's caveat in this province. One member of the Advisory Committee suggested using a modified form of caveat (as distinct from registering the actual crystallized floating charge) in order to protect the holder of a crystallized floating charge on land. The scheme adopted by the Commission is based, in part, on that proposal.

10. S. 28 (reproduced in Appendix A).

11. *Re Household Products Co. Ltd. and Federal Business Development Bank*, (1981) 124 D.L.R. (3rd) 325 (Ont. H.C.J.); *In re Benjamin Cope & Sons Ltd.*, [1914] 1 Ch. 800. This general rule does not apply if the instrument creating the first floating charge envisages the creation of a second floating charge: *In re Automatic Bottle Makers, Ltd.*, [1926] 1 Ch. 412 (C.A.).

12. *See Re Household Products*, *ibid.*, and *cf. Federal Business Development Bank* v. *Prince Albert Fashion Bin Ltd. et al.*, [1983] 3 W.W.R. 464 (Sask. C.A.).

13. Our recommended priority rule takes into account the possibility that a crystallized floating charge could be registered against a parcel of land even though it had not been previously registered at the Personal Property Registry. As between competing floating charges, the date for determining the priority of a particular floating charge should be the earlier of the date of registration (if any) at the Personal Property Registry and the date of registration against the parcel of land.

In very rare circumstances, the combined operation of the general priority rule under the *Land Title Act* and the special rule for competing floating charges will create a complex situation of a kind which is sometimes characterized as a "circular priority" problem. Our recommended draft legislation provides a solution to this problem but, in view of the infrequency with which it will arise, we have relegated a discussion of it to an appendix.[14]

3. Procedure

The Advisory Committee made two recommendations concerning procedural matters. The first was that a person applying to register a crystallized floating charge against a parcel of land should be required to make a statutory declaration that the charge has crystallized. This answers the need for a way of establishing to the satisfaction of land title officials that the charge has, in fact, crystallized. The second recommendation was that there should be a procedure for recording against title to land the date when a charge was registered at the Personal Property Registry, since that date will determine the priority between competing floating charges against the land.[15] We endorse both these recommendations.

Due to the procedural nature of these two recommendations, we believe they are best dealt with by regulation. In this way, the procedures can be fine-tuned by those responsible for the operation of the land title system. The draft legislation set out in the next chapter includes a provision expressly authorizing the creation of appropriate regulations.

D. Transition

At least two transitional issues arise out of the recommendations made. The first concerns the status of uncrystallized floating charges currently registered against parcels of land. As a general rule, new statutory provisions do not affect rights accrued under the previous law.[16] There is no reason to

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14. *See* Appendix C.
15. This could be achieved by requiring production of a certificate setting out the date; *see* subsection (10)(b) of the draft legislation in Chapter IV.
16. *See* Elmer A. Driedger, *Construction of Statutes* (2d ed., 1983) 183-185 and Pierre-André Côté, *The Interpretation of Legislation in Canada* (1984) 91-102. *Cf. Interpretation Act*, R.S.B.C. 1979, c. 206, s. 35(c), which deals with the effect of repealing a statutory provision.

depart from this general principle and we therefore recommend that new legislation leave undisturbed whatever rights[17] are presently enjoyed by the holder of a floating charge registered against land before the charge has crystallized.

A second issue concerns the status of floating charges presently registered only with the Registrar of Companies. At some point after the proposed *Personal Property Security Act* (hereafter PPSA) comes into force, the register of corporate mortgages under the *Company Act* will cease to be used. The draft PPSA contains transitional provisions[18] which bring into the Personal Property Registry those corporate securities which have been registered under the *Company Act*. These provisions, however, apply only to security interests which are governed by the PPSA. They do not cover floating charges on land. It is therefore necessary to make provision for the continuation of *Company Act* registrations of floating charges on land. We believe the best approach to this question is to authorize the creation of regulations which would apply the transitional provisions in the PPSA to those floating charges on land currently registered under the *Company Act*. Appendix D contains a fuller discussion of these transitional issues.

17. As noted previously, the precise nature of these rights is not entirely clear.
18. S. 77(3), reproduced in Appendix B.

CHAPTER IV DRAFT LEGISLATION

A. Overview

This chapter contains annotated draft legislation which gives effect to the general recommendations for reform contained in the previous chapter. The legislation consists of a single section to be added to the *Land Title Act*.

As was noted in Chapter II, the common law floating charge has not fitted well into the statutory scheme for registering interests in land. One reason for this is that our system of land registration is designed to accommodate only interests which have affixed to specific parcels of land. We believe that the recommended scheme provides a regime which accommodates both the needs of the holder of a floating charge and the characteristics of the land title system. Before crystallization, the primary protection sought by the holder of a floating charge is against a trustee in bankruptcy of the debtor and against a subsequent floating charge granted by the debtor.[1] Our scheme provides this protection yet leaves the debtor free to deal with its land. A third party acquiring an interest in the land is unaffected by an uncrystallized floating charge unless he is a trustee in bankruptcy or the holder of a subsequent floating charge. After crystallization, the holder of a floating charge is able to protect himself against subsequent interests in the land by registering the crystallized charge against specific parcels of land owned by the debtor.

1. If the chargeholder wants additional protection, he takes a fixed mortgage against specific parcels of land.

B. Draft *Land Title Amendment Act*

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows:

1. The *Land Title Act*, R.S.B.C. 1979, c. 219, is amended by adding the following section:

Floating charges

198.1. (1) In this section

"circular priority" means the situation where three or more competing charges have been registered against the same parcel of land and the application of subsections (6) and (7) leads to a priority relationship among them where each charge is subordinate in priority to at least one other of the charges.

The term "circular priority" is used in subsection (8); see the comments under that subsection.

"crystallized", with reference to a floating charge, means a charge which has fixed upon specific land in accordance with the terms of the instrument in which the charge is created and the applicable law;

The instrument creating a floating charge usually sets out the events which will cause the charge to crystallize and thereby become a fixed equitable mortgage against property covered by the charge.

"financing statement" has the same meaning as in the *Personal Property Security Act*;

A financing statement is the document used to register a security interest under the *Personal Property Security Act*. It is defined in section 1 of that Act; see Appendix B.

"floating charge" means a charge which secures the payment or performance of an obligation but does not become a fixed charge on specific land until the occurrence of a stipulated event.

This definition of floating charge simply describes a common law floating charge on land. "Charge" is defined in section 1 of the *Land Title Act* as applying only to charges on land.

A floating charge usually covers both after-acquired land as well as land presently owned by the debtor but it need not do so.

The definition does not include a fixed equitable mortgage on future acquired land.

(2) Registration of a financing statement respecting a floating charge in the Personal Property Registry established under the *Personal Property Security Act* constitutes registration of the charge. The Personal Property Registry is the proper office for registration of an uncrystallized floating charge.

This provision allows a floating charge to be registered at the Personal Property Registry.

"Financing statement" is defined in subsection (1). It is the document used under the *Personal Property Security Act* in order to register a charge at the Personal Property Registry.

This subsection clarifies that registration of a floating charge on land at the Personal Property Registry is sufficient to give to the holder of the charge the priority available (under section 75 of the federal *Bankruptcy Act*) to provincially registered security interests.

Cf. Daon Development Corp. v. *National Trust Co. Ltd.*, (1982) 39 B.C.L.R. 341 (S.C.) and s. 79(1)(a) of the *Company Act*.

If for some reason a floating charge on land was not registered at the Personal Property Registry but, after crystallization, was registered under subsection (4) against a parcel of land prior to registration of a receiving order or assignment in bankruptcy, the holder of the charge would be able to rely upon subsection (6) in order to gain priority over the trustee in bankruptcy.

Registration under this provision also protects the floating charge against a subsequent floating charge. See the priority rule in subsection (7).

Registration of a floating charge under this provision does not give the holder of the charge protection against a charge or other interest in land registered at a land title office against a specific parcel of land.

Although the circumstances are very limited in which he might wish to do so, a holder of a floating charge on land could register his charge at the Personal Property Registry even after it has crystallized.

(3) Where a floating charge and a security interest in personal property are created by the same instrument, registration with respect to that security interest under the *Personal Property Security Act* also constitutes registration of the floating charge under subsection (2).

This provision clarifies that a single financing statement may be used to register a security instrument which covers personal property and also grants a floating charge covering land.

(4) Notice of a crystallized floating charge may be registered against a parcel of land charged by it.

This subsection expressly allows the registration of a crystallized floating charge against a parcel of land.

This registration is done by means of a notice; unlike with other charges, the instrument (or a certified copy) creating the charge is not registered.

Special procedures for registering a crystallized floating charge are to be dealt with by regulation; see subsection (10)(a) and (b).

Registration under the *Land Title Act* protects the holder of a crystallized floating charge against persons subsequently registering an interest in the land against which the charge is registered.

The specific rules governing the priority between a registered floating charge and other interests in the land are set out in subsections (6), (7) and (8).

The form and content of the notice is subject to regulations; see subsection 10(a) and (b).

(5) Except as provided in subsections (2) and (4), a floating charge may not be registered under this Act.

This provision reverses the current law and prevents the registration of a floating charge against a parcel of land until after the charge has crystallized.

Currently, the registration of an uncrystallized floating charge against a parcel of land has the practical effect of inhibiting the ability of the debtor to deal with the land.

Subsection (5) ensures that a debtor remains free to deal with its land prior to crystallization of the floating charge. This freedom is an important characteristic of the floating charge.

(6) Where a notice has been registered under subsection (4), the priority of the crystallized floating charge shall be determined according to the date and time the application for registration was received by the registrar.

At common law, when a floating charge crystallizes, it becomes a fixed equitable mortgage on all property covered by the charge.

Sections 27 and 28 of the *Land Title Act* state that the priority of a charge on land is determined by the date and time when its application for registration was received by the registrar of land title.

The effect of subsection (6) is that the priority rules contained in sections 27 and 28 of the Act apply to a notice registered after a floating charge on land has crystallized.

Subject to section 29 of the Act, where notice of a crystallized floating charge has been registered under subsection (4) against a parcel of land, the holder of the charge is protected against persons who subsequently register an interest in the land.

(7) Notwithstanding subsection (6), priority between crystallized floating charges that charge the same parcel of land shall be determined by the date of registration under subsection (2) or subsection (4), whichever is the earlier.

Subsection (7) creates a special priority rule for when a parcel of land is covered by more than one crystallized floating charge.

The effect of this provision is that, as against another floating charge covering the same land, a floating charge has priority from either the date of registration at the Personal Property Registry or the date of registration at a land title office against a specific parcel of land, whichever occurs first.

This subsection is designed to protect the commercial expectations of the parties. The floating charge on land would lose much of its usefulness if it could be defeated by a subsequent floating charge in circumstances where the first charge had been duly registered under subsection (2) at the Personal Property Registry.

At common law, the critical dates for determining priorities between competing floating charges are the dates of execution of the floating charges, not the dates when the charges crystallize.

See the discussion of this point in Chapter III.

(8) Where a circular priority exists, the rights of the parties shall be resolved by allowing the person having priority under subsection (7) to pursue his claim as if he were subrogated to the claim of the person otherwise having priority under subsection (6).

"Circular priority" is defined in subsection (1).

In rare circumstances, a circular priority situation is created by the combined operation of the different priority rules contained in subsections (6) and (7).

Subsection (8) provides a solution to this circular priority situation.

By using principles of subrogation, the position of the intervening encumbrance holder is protected and the resulting position of all the charge holders is the same as that typically adopted by the courts in such situations. *Cf. In re Woodroffes (Musical Instruments) Ltd.*, [1986] 1 Ch. 366, 375.

See the discussion in Appendix C.

(9) The priority of a floating charge registered against a specific parcel of land before this section comes into force shall be determined without regard to this section.

This provision preserves existing rights under a floating charge registered against a parcel of land before the draft legislation comes into force.

(10) The Lieutenant Governor in Council may make regulations

(a) respecting the form, content and manner of use of forms to be used for registration under this section;

This provision authorizes regulations specifying what information and other material is to be contained in a notice registered at either the Personal Property Registry or a land title office.

(b) respecting the form and manner in which an application for registration of a notice under subsection (4) is to be made and the evidence to be produced in support of the application;

This power to make regulations would allow those persons responsible for administering the land title system to require a person applying to register a notice under subsection (4) to make a statutory declaration that the floating charge has crystallized.

It would authorize a regulation requiring a person applying to register a notice of a crystallized floating charge to provide, for inspection by the registrar of land title, a copy of the instrument creating the charge.

It would also allow the imposition of a requirement that a person seeking to register a notice under subsection (4) must provide a certificate which states when (if at all) the floating charge was registered at the Personal Property Registry.

See the discussion in Chapter III.

(c) respecting the application of any provision of the *Personal Property Security Act*, or of any regulations made under it, to

(i) the registration of a financing statement under subsection (2),

(ii) the disclosure of information concerning a floating charge registered under subsection (2) or a crystallized floating charge notice of which has been registered under subsection (4),

(iii) the status or effect of a registration, in the Office of the Registrar of Companies, made in respect to a floating charge before this section comes into force;

This provision serves a number of purposes.

Section 78 of the PPSA gives the Lieutenant Governor in Council a variety of regulation making powers to assist in the administration of that Act. Subsection (10)(c)(i) of the draft legislation creates a mechanism so that administrative regulations made under the PPSA can be extended to apply to the registration of floating charges on land under subsection (2). For example, a regulation could require that a financing statement indicate whether it covers a floating charge on land.

Section 18 of the PPSA (reproduced in Appendix B) allows a creditor with an interest in a debtor's personal property to obtain from another secured creditor a copy of a security instrument where notice of it has been registered under that Act. Subsection (10)(c)(ii) authorizes a regulation extending this disclosure requirement to persons who have registered a floating charge on land under either subsection (2) or (4) of this draft amendment to the *Land Title Act*.

Subsection (10)(c)(iii) allows transition provisions (such as section 77) in the PPSA to be applied to floating charges on land currently registered in the Office of the Registrar of Companies. For a discussion of this transitional issue, see Appendix D.

(d) respecting fees for registration of notices under this section.

Self-explanatory.

CHAPTER V CONCLUSION

A. Summary

Floating charges on land serve a limited but, nonetheless, useful function in commercial financing. It is therefore necessary to ensure that they are accommodated within the schemes for registering security interests against various types of property.

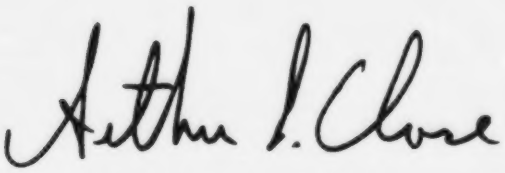
In the near future, adoption of a *Personal Property Security Act* will substantially alter the way in which corporate security interests are registered. At that time, floating charges on land, as a security device, will be jeopardized unless steps are taken to create a new scheme for registering uncrystallized charges. An independent reason for undertaking reform is that a number of problems exist under the current regime for registering floating charges on land.

The scheme recommended in this Report provides a simple but effective way of meeting the needs of those who use floating charges on land as a tool in structuring commercial loans. It utilizes existing registries and is therefore cost-efficient from the point of view of both the government and those involved in commercial financing.

B. Acknowledgments

We wish to thank the members of the Advisory Committee on Floating Charges on Land and in particular the chairman, Professor T. Wuester of the Faculty of Law at the University of Victoria. A full list of the members is set out in Appendix E. These individuals devoted much time and energy to the work of the Committee and their contribution is greatly appreciated.

We would also like to acknowledge the contribution of J. Bruce McKinnon, a Legal Research Officer to the Commission. He acted as secretary and reporter to the Advisory Committee and later, subject to the direction of the Commission, drafted this Report.



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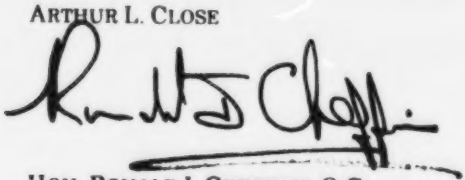

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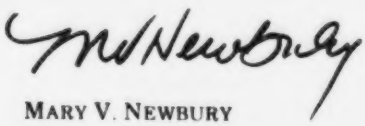

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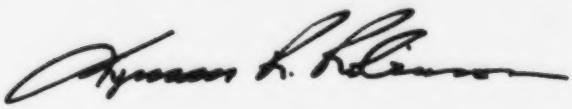

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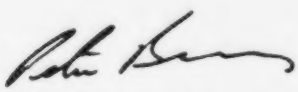

PETER T. BURNS, Q.C.

APPENDICES

APPENDIX A

Selected Statutory Provisions

Bankruptcy Act, R.S.C. 1985, c. B-3, s. 75

Law of province to apply in favour of purchaser for value

53. Notwithstanding anything in this Act, a deed, conveyance, transfer, agreement for sale, mortgage, charge or hypothec made to or in favour of a *bona fide* purchaser or mortgagee for adequate valuable consideration and covering any real property affected by a receiving order or an assignment under this Act is valid and effectual according to the tenor thereof and according to the laws of the province in which the property is situated as fully and effectually and to all intents and purposes as if no receiving order or assignment had been made under this Act, unless the receiving order or assignment, or notice thereof, or caution, has been registered against the property in the proper office prior to the registration of the deed, conveyance, transfer, agreement for sale, mortgage, charge or hypothec in accordance with the laws of the province in which the property is situated.

Company Act, R.S.B.C. 1979, c. 59, ss. 75 and 79

Registration of charges

75. (1) A mortgage created by a company on land only to which the *Land Title Act* applies, shall be registered, in accordance with that Act, in the office of the registrar.

(2) Every mortgage created by a company on land to which the *Land Title Act* applies, other than a mortgage under subsection (1), shall be registered in the office of the registrar by filing with him an original or a certified or executed copy of the instrument by which the mortgage is created. The registrar shall certify, by endorsement on the original instrument, or on an original or a certified or executed copy, that the mortgage is registered in his office and the date of the registration.

(3) Where a company creates

(a) a single debenture containing a charge; or

(b) a series of debentures containing a charge to which the debentureholders of that series are entitled without preference,

and the charge is not included in a deed creating or defining the security, the charge shall be registered by filing with the registrar

(c) an original or a certified or executed copy of the single debenture; or

(d) an original or a certified or executed copy of one of the debentures of the series and a statement setting out

(i) the total amount secured by the whole series; and

(ii) the name and address of a trustee for the debentureholders.

(4) A mortgage created by a company that is otherwise required to be registered under this section and that charges a motor vehicle as defined by the *Chattel Mortgage Act*, and contains a description of the motor

vehicle in compliance with that Act, shall be registered by filing with the registrar the instrument by which the mortgage is created or evidenced or a certified or an executed copy of it, together with the particulars prescribed in Form 5 in the Second Schedule, and the registrar shall transmit those particulars to the registrar general.

(5) A mortgage created by a company in or out of the Province

(a) for the purpose of securing any debenture;

(b) on land;

(c) as a floating charge on the whole or any part of its undertaking or property; or

(d) on goodwill, on a patent or licence under a patent, on a trade mark, or on a copyright or licence under a copyright,

shall, unless registered under a preceding subsection, be registered by filing with the registrar the instrument by which the mortgage is created or evidenced, or a certified or an executed copy of it.

(6) The filing of a mortgage, debenture or other instrument in accordance with a subsection of this section shall be deemed to be a filing of the instrument in accordance with every other subsection of this section that requires filing of the instrument.

(7) A mortgage registered under a former *Companies Act* by filing particulars or otherwise shall be deemed to be a mortgage registered in accordance with this Act.

(8) A mortgage registered under this Act by a corporation before it was continued under section 37 and concerning which no memorandum has been entered on the register under section 83 (1) continues to be registered under this Act, notwithstanding the continuance of the corporation under section 37.

(9) Nothing in this section requires registration of an equitable mortgage created by deposit of a duplicate indefeasible title, as defined in the *Land Title Act*, whether or not the equitable mortgage is evidenced by a memorandum of deposit or other instrument.

(10) Where, before subsection (9) comes into force, a company created an equitable mortgage by the deposit of a duplicate indefeasible title, as defined in the *Land Title Act*, whether or not the equitable mortgage is evidenced by a memorandum of deposit or other instrument, the equitable mortgage is not invalid nor its legal effect impaired by reason only that it was not registered in the office of the registrar.

Unregistered mortgage

79. (1) Except as provided in subsection (2), a mortgage that is not registered in accordance with this Act is, as against

(a) a trustee in bankruptcy, liquidator, receiver, receiver manager or assignee of the property of the company for the benefit of its creditors, void at the time of and after his appointment;

(b) sheriffs, sheriffs' officers and other persons seizing property comprised in the mortgage in execution of a process of a court of competent jurisdiction, void at the time of and after the execution of the process;

(c) every person by whom or on whose behalf the process referred to in paragraph (b) was issued, void at the time of and after the execution of the process;

(d) a creditor of the company on whose behalf any property comprised in the mortgage is attached in execution of a process of a court of competent jurisdiction, void at the time of and after the execution of the process;

(e) a subsequent bona fide purchaser for valuable consideration who, before registration of the mortgage, either has obtained possession of property charged by the mortgage or has registered in his favour a bill of sale of any of the property charged by the mortgage, void in respect of that property at the time of and after the purchase; and

(f) a subsequent bona fide mortgagee of any of the property charged by the mortgage, whose mortgage is registered in accordance with this Act, the *Book Accounts Assignment Act*, or the *Chattel Mortgage Act*, void in respect of that property at the time of and after registration of the mortgage in favour of the subsequent bona fide mortgagee.

(2) No mortgage that is registered under the *Land Title Act* is void under subsection (1) by reason of the fact that the mortgage is not registered under this Act; but this provision operates only to confirm the security on property concerning which a mortgage under *Land Title Act* is duly registered.

(3) Where a mortgage becomes void under subsection (1),

(a) any contract or obligation for repayment of the money secured by it is not affected; and

(b) the money secured by it becomes payable on demand.

Land Title Act, R.S.B.C. 1979, c. 219

ss. 20, 22, 23, 26, 28, 29 and 198

Unregistered instrument inoperative to pass estate

20. (1) Except as against the person making it, no instrument purporting to transfer, charge, deal with or affect land or an estate or interest in it is operative to pass an estate or interest, either at law or in equity, in the land unless the instrument is registered in compliance with this Act.

(2) Every instrument referred to in subsection (1) confers on every person benefited by it and on every person claiming through or under him, whether by descent, purchase or otherwise, the right to apply to have the instrument registered, and, in proceedings incidental or auxiliary to registration, to use the names of all parties to the instrument, whether or not a party has since died or become legally incapacitated.

(3) Subsection (1) does not apply to a lease or agreement for lease for a term not exceeding 3 years where there is actual occupation under the lease or agreement.

Operation of instrument as from time of registration

22. Every instrument purporting to transfer, charge, deal with or affect land or an estate or interest in it shall pass the estate or interest either at law or in equity created or covered by the instrument at the time of its registration, irrespective of the date of its execution.

Effect of indefeasible title

23. (1) Every indefeasible title, as long as it remains in force and uncancelled, shall be conclusive evidence at law and in equity, as against the Crown and all other persons, that the person named in the title is indefeasibly entitled to an estate in fee simple to the land described in the indefeasible title, subject to

(a) the subsisting conditions, provisos, restrictions, exceptions and reservations, including royalties, contained in the original grant or contained in any other grant or disposition from the Crown;

(b) a federal or Provincial tax, rate or assessment at the date of the application for registration imposed or made a lien or which may after that date be imposed or made a lien on the land;

(c) a municipal charge, rate or assessment at the date of the application for registration imposed or which may after that date be imposed on the land, or which had before that date been imposed for local improvements or otherwise and which was not then due and payable, including a charge, rate or assessment imposed by a public body having taxing powers over an area in which the land is situated;

(d) a lease or agreement for lease for a term not exceeding 3 years where there is actual occupation under the lease or agreement;

(e) a highway or public right of way, watercourse, right of water or other public easement;

(f) a right of expropriation or to an escheat under an Act;

(g) [Repealed 1981-10-24, proclaimed effective Nove. 30, 1981.]

(h) a caution, caveat, charge, claim of builder's lien, condition, entry, exception, judgment, lis pendens, notice, reservation, right of entry, transfer or other matter noted or endorsed on the title or which may be noted or endorsed subsequent to the date of the registration of the title;

(i) the right of a person to show that the whole or a portion of the land is, by wrong description of boundaries or parcels, improperly included in the title;

(j) the right of a person to show fraud, including forgery, in which the registered owner, or the person from or through whom the registered owner derived his right or title otherwise than bona fide for value, has participated in any degree; and

(k) a restrictive condition, right of reverter, or obligation imposed on the land by the *Forest Act*, endorsed on the title.

(2) After an indefeasible title is registered, no title adverse to or in derogation of the title of the registered owner shall be acquired by length of possession.

(3) Notwithstanding subsection (2), in case only of the first indefeasible title registered, it is void against the title of a person adversely in actual possession of and rightly entitled to the land included in the indefeasible title at the time registration was applied for and who continues in possession.

(4) In this section "courts" includes a person or statutory body having, by law or consent of parties, authority to hear, receive and examine evidence.

Effect of registration of a charge

26. A registered owner of a charge shall be deemed to be entitled to the estate or interest in respect of which he is registered, subject only to such exceptions, registered charges and endorsements as appear existing on or are deemed to be incorporated in the register.

Priority of charges based on priority of registration

28. When 2 or more charges appear entered on the register affecting the same land, the charges have, as between themselves, but subject to a contrary intention appearing from the instruments creating the charges, priority according to the date and time the respective applications for registration of the charges were received by the registrar, and not according to the respective dates of execution of the instruments.

Effect of notice of unregistered interest

29. (1) Except in the case of fraud in which he has participated, no person contracting or dealing with or taking or proposing to take from a registered owner

(a) a transfer of land; or

(b) a charge on land, or a transfer or assignment or subcharge of the charge,

shall be affected by a notice, express, implied, or constructive, of an unregistered interest affecting the land or charge other than

(c) an interest, the registration of which is pending;

(d) a lease or agreement for lease for a period not exceeding 3 years where there is actual occupation under the lease or agreement; or

(e) the title of a person against which the indefeasible title is void under section 23(3),

notwithstanding a rule of law or equity to the contrary.

(2) For the purpose of this section "registered owner" includes a person who has made an application for registration and becomes a registered owner as a result of that application.

Charge created by corporation

198. (1) Where, by an instrument, a corporation creates a charge, the charge may be registered under this Act without proof that it has been registered with the Registrar of Companies.

(2) Where, by an instrument, a corporation creates a charge on land only and the charge is required to be registered with the Registrar of Companies under an Act or law, the applicant shall tender to the registrar, at the time he makes application under this Act to register the charge, a true copy of the instrument.

(3) Where a true copy of an instrument is tendered to the registrar under subsection (2), the registrar shall transmit it to the Registrar of Companies after the copy has been stamped with the date and time when the application was received.

(4) Where a debenture, as defined in the *Company Act*, creates a charge on land, the registrar may register the charge on application supported by

(a) the debenture,

(b) a copy of the debenture that has been certified by the Registrar of Companies to be a true copy of the debenture,

(c) a copy of the debenture that has been compared by the registrar with the debenture or that has been made by the registrar and certified by him to be a true copy of the debenture, or

(d) a copy of the debenture

(i) that has been executed by the corporation issuing it under its seal and the execution has been proved in accordance with this Act, and

(ii) on which the words "executed copy" or words of like effect have been endorsed on the first page or on the execution page.

(5) Where an application to register a copy of a debenture under subsection (4) has been accepted by the registrar and the charge created by it has been registered,

(a) the registrar shall note that fact in the register,

(b) the registration of the charge shall constitute notice and conclusive proof of the contents of the debenture, so far as the debenture relates to the estate or interest created by the debenture, to all persons dealing with the title to the land affected, and

(c) the copy has, to the extent necessary to give effect to paragraph (b), the same effect as if it were the debenture.

(6) The charge created by a debenture registered under this Act before the coming into force of this section is not void by reason only that the copy of the debenture accepted by the registrar

(a) has not been certified by the Registrar of Companies or the registrar before its registration, or

(b) was not a copy as defined in the *Company Act*.

APPENDIX B

Draft *Personal Property Security Act*

(released April 1988)

Selected Provisions

[Section 1]

"financing statement" means a writing in prescribed form required or permitted to be registered under this Act and, where the context requires, includes a financing change statement and a security agreement registered prior to the date this Act comes into force;

Acquisition of information from secured parties

18. (1) The debtor, a creditor, a sheriff, a person with an interest in personal property of the debtor, or an authorized representative of any of them, may, by a demand in writing containing an address for reply and delivered to the secured party at his address in a financing statement or security agreement containing a description of the personal property, or more recent address if known by the person making the demand, require the secured party to send or make available to the person making the demand or, if the demand is made by the debtor, to any person at an address specified by the debtor, one or more of the following

(a) a copy of any security agreement providing for a security interest held by the secured party in the personal property of the debtor;

(b) a statement in writing of the amount of the indebtedness and of the terms of payment of the indebtedness, as of the date specified in the demand;

(c) a written approval or correction of an itemized list of personal property attached to the demand indicating which items are collateral as of the date specified in the demand;

(d) a written approval or correction of the amount of the indebtedness and of the terms of payment of the indebtedness, as of the date specified in the demand;

(e) sufficient information as to the location of the security agreement or a copy of it to enable a person entitled to receive a copy of the security agreement to inspect it.

(2) A person with an interest in personal property of the debtor is entitled to make a demand under subsection (1) only with respect to a security agreement providing for a security interest in the property.

(3) The secured party, on the reasonable demand of the person entitled to receive a copy of the security agreement under subsection (1), shall permit him or his authorized representative to inspect the security agreement or a copy of it during normal business hours at the location mentioned in subsection (1)(e).

(4) Where a demand is made in accordance with subsection (1)(c) and the secured party claims a security interest in all of the personal property of the debtor, in all the property of the debtor other than a specified kind or item of property or in all of a specified kind of property of the debtor, the

secured party may indicate this in lieu of approving or correcting the itemized list of the property.

(5) The secured party shall reply to the demand made under subsection (1) or (3) not later than 10 days after the demand is made, and if, without reasonable excuse, the secured party fails to do so or in the case of a demand his reply is incomplete or incorrect, the person making the demand, in addition to any other remedy provided by this Act, may apply to a court for an order requiring the secured party to comply with the demand.

(6) Where a person receiving a demand under subsection (1) or (3) no longer has an interest in the obligation or property of the debtor that is the subject of the demand, he shall, not later than 10 days after receiving the demand, disclose the name and address of his successor in interest and the latest successor in interest, if known to him, and if, without reasonable excuse, this is not done, the person making the demand, in addition to any other remedy provided in this Act, may apply to a court for an order requiring the person to whom the demand has been made to comply with this section.

(7) On application under subsection (5) or (6), the court may make an order requiring

(a) the secured party in subsection (5) to comply with the demand mentioned in that subsection, or

(b) the person receiving the demand in subsection (6) to disclose the information mentioned in that section,

and if the order is not complied with may order that the security interest of the secured party with respect to which the demand was made is unperfected or extinguished and that any related registration be discharged, and may make any other order it considers necessary to ensure compliance with the demand.

(8) On an application mentioned in subsection (7) or on an application of the secured party mentioned in subsection (5) or the person mentioned in subsection (6) as receiving the demand, the court, subject to section 69(1), may exempt the secured party or person receiving the demand in whole or in part from complying with subsection (5) or (6), other than a demand made by the debtor, or may extend the time for compliance.

(9) A secured party who has replied to a demand mentioned in subsection (1) is estopped for the purposes of this Act, against the person making the demand and any other person who can reasonably be expected to rely on the reply, to the extent that the person making the demand or the other person, as the case may be, has relied on the reply, from denying

(a) the accuracy of the information contained in the reply to the demand under subsection (1)(b), (c) or (d), and

(b) that the copy of the security agreement that he provided in response to a demand under subsection (1)(a) is a true copy of the security agreement required to be provided under subsection (1)(a).

(10) A successor in interest mentioned in subsection (6) is estopped for the purposes of this Act, as against the person making the demand mentioned in subsection (1) and any other person who can reasonably be expected to rely on the reply to the demand, to the extent that the person

making the demand or the other person, as the case may be, has relied on the reply, from denying

(a) the accuracy of the information contained in the reply to the demand under subsection (1)(b), (c) or (d), and

(b) that the copy of the security agreement that is provided in response to a demand under subsection (1)(a) is a true copy of the security agreement required to be provided under subsection (1)(a)

unless

(c) the person who relied on the reply knows that the interest has been transferred to the successor in interest and knows his identity and address, or

(d) prior to the demand, a financing change statement has been registered as provided in section 45 disclosing the successor in interest as the secured party.

(11) The person to whom a demand is made under this section may require payment in advance of a fee in a prescribed amount for each demand, but the debtor is entitled to a reply without charge once every 6 months.

Personal Property Registry

42. (1) There shall be a registry known as the Personal Property Registry for the purposes of registrations under this Act and for registrations that are permitted or required to be registered under any other Act to be made in the registry.

Transition: Registrations

77. (3) A registration of a prior security interest in

(a) the office of the Registrar of Companies as provided by

(i) the *Company Act*,

(ii) section 4(2) of the *Sale of Goods on Condition Act*, to the extent that the security interest is not taken in a motor vehicle as defined in the *Sale of Goods on Condition Act*,

(iii) section 7 of the *Chattel Mortgage Act*, to the extent that the security interest is not taken in a motor vehicle as defined in the *Chattel Mortgage Act*,

(iv) section 5 of the *Book Accounts Assignment Act*, to the extent it applies to a registration of an assignment made by a corporation, and

(v) section 136 of the *Railway Act*,

(b) the office of the Registrar General pursuant to section 75(4) of the *Company Act*, or

(c) the office of the Provincial Secretary as provided in section 31 of the *Sale of Goods on Condition Act*

is deemed to have been registered and perfected under this Act, and the perfected status of the interest expires 5 years from the date this section comes into force, but may be further continued under this Act by registration under this Act if the security interest could have been perfected by registration if it had attached after this Act comes into force.

APPENDIX C

CIRCULAR PRIORITIES

The way in which a circular priority situation can arise under our recommendations is best explained by means of an illustration:

Apr. 1 -	A debtor grants a floating charge to A as security for $100,000; it is immediately registered at the Personal Property Registry.
May 1 -	The debtor grants a second floating charge to B for $75,000 and it also is immediately registered at the Personal Property Registry.
July 1 -	The debtor's business enters financial difficulty.
Aug. 2 -	B crystallizes his floating charge and registers it against Blackacre (the only land owned by the debtor).
Aug. 4 -	An encumbrance for $5,000 is registered against Blackacre by C.
Aug. 7 -	A crystallizes his floating charge and registers it against Blackacre.
Nov. 1 -	Blackacre is sold in a judicial sale and the proceeds amount to $120,000.

The difficulty in this situation arises from the fact that the order of registration of the two competing floating charges in the Land Title Office differs from the order of registration at the Personal Property Registry, and that an intervening encumbrance was registered in the Land Title Office between the two crystallized floating charges. The combined operation of two priority rules[1] creates a circular priority. B has priority over C, who has priority over A, who (because of the special rule for competing floating charges) has priority over B.

How should the rights of the parties be resolved in such a situation? A starting point is to consider the position from C's point of view. He has acquired his rights to Blackacre on the basis of the records of the Land Title Office and should not be affected by the priority implications of a registration

1. Subsections (6) and (7) of the draft legislation in Chapter IV.

scheme in which he is disinterested. When C acquired his rights, Blackacre was encumbered to the extent of only $75,000, so once the recovery reaches that amount any excess should be applied to C's claim until it is fully satisfied. The first $75,000, and any additional money recovered after C's claim is satisfied, would be divided between A and B on some basis. There seems to be general agreement that this is the correct approach.[2]

Once C's claim is dealt with according to the theory set out above, how should the remaining money recovered be divided between A and B? Here we encounter two competing theories. The first is simply to divide the money according to the priorities that would have prevailed if C's claim had not intervened. This is the most popular solution and is the one which the courts tend to adopt when such a situation arises.[3] For convenience we refer to this as the "judicial solution." Under the judicial solution to the problem posed, A would receive $100,000, B $15,000 and C $5,000.[4]

The competing theory would lead to a somewhat different distribution. Where a claim like C's intervenes, the total funds available to satisfy the claims of A and B are diminished and it will be noted that the judicial solution causes any loss arising from this diminution to be borne by B. On one view, at least, this is unfair to B. When he crystallizes his charge and registers it against Blackacre, his legitimate expectation is that he will be vulnerable only to A's floating charge (value $100,000) and nothing more. The judicial solution makes him vulnerable to additional loss.

B would argue that any loss should fall on A. This could be done by calculating the recovery of the parties as in the judicial solution, and then transferring from A to B an amount equal to the shortfall created by C's claim. This is the competing theory and it is the one urged on us by our Advis-

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2. A different approach might be to pro rate the recovery of the parties. This approach would mean, however, that a very small intervening claim by C could drastically alter the relative recoveries of A and B. For that reason, it is unacceptable.

3. *See, e.g., In re Woodroffes Musical Instruments Ltd.*, [1986] 1 Ch. 366, 375 *per* Nourse J.; this English case involved two floating charges and a competing third interest consisting of preferred creditors.

4. More precisely, A would receive $75,000, C would receive $5,000, A would receive a further $25,000 (the balance remaining on his claim), and B would then receive the final $15,000.

ory Committee. Under the "Committee solution" to the problem posed, A would receive $95,000, B $20,000 and C $5,000.[5]

The Commission concluded that it should not adopt the approach recommended by the Advisory Committee. The draft legislation in Chapter IV mandates the judicial solution to this type of circular priority problem. There are two reasons for adopting the judicial solution. First, the equities are not so clearly in B's favour that a departure from the most widely accepted way of resolving this kind of problem is warranted. Second and more important, anomalous results occur in some circumstances with the rule suggested by the Advisory Committee. In certain situations, the proceeds received by A actually *decrease* as the sale proceeds increase. This is illustrated by varying the figures of the previous example:

> A's floating charge is for $60,000, B's floating charge is for $100,000 and C's intervening encumbrance is for $200,000.

If the sale proceeds are $100,000, the parties will receive the following amounts:

B: $40,000; C: nil; A: $60,000

If the sale proceeds increase to $280,000, the following result occurs:

B: $100,000; C: $180,000; A: nil

The amount received by A decreases from $60,000 to nil despite a significant increase in the proceeds from the sale of the land. Such a result is difficult to justify and does not occur under the judicial solution.

In order to make sure that we had a secure understanding of how these two ways of resolving a circular priority problem operate, we designed and ran a computer programme which applied the two rules to a wide range of situations. Figures 1 and 2, which appear at the end of this Appendix, are graphs that show the operation of the judicial solution and the rule recommended by the Advisory Committee. The claims of A, B and C are the same as in the second example above. The

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5. This result is achieved by using the judicial solution (*see*, *supra*, n. 4) and then adjusting the result so that $5,000 is deducted from A's share and is given to B. As a result, A's share is reduced from $100,000 to $95,000 and B's share increases from $15,000 to $20,000.

graphs illustrate how the amounts received by A, B and C change as the sale proceeds increase from nil to $220,000 (an amount sufficient to satisfy all three claims). The results reflected in these graphs confirm our view that the judicial approach is the appropriate way of resolving this circular priority problem.

We then confronted the question whether our draft legislation should deal with circular priorities at all, since our preferred solution was the one likely to be adopted in any event. Our conclusion was that there was some virtue in providing statutory guidance on this issue, provided a circular priority rule could be drafted succinctly enough that this question did not appear to receive more attention than it warranted. This presented a drafting challenge, both to describe when a circular priority exists and to state a rule to deal with it. We believe we have met this challenge. The draft legislation in Chapter IV sets out a brief definition of "circular priority" and, in subsection (8), formulates a rule for resolving a circular priority. It relies upon the doctrine of subrogation as the means to achieve the appropriate arrangement of the priorities between the competing floating charges and an intervening encumbrance.[6]

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6. By using the doctrine of subrogation, A (in the example in the text) is able to pursue his claim by standing in the shoes of B (to the extent that B has priority over C). For the use of subrogation as a means to resolve this type of circular priority, *see* R.M. Goode, *Legal Problems of Credit and Security* (1982) 54-55; Megarry and Wade, *The Law of Real Property* (5th ed., 1984) 1001-1002; Baker and Langan, *Snell's Principles of Equity* (28th ed., 1982) 429.

FIGURE 1

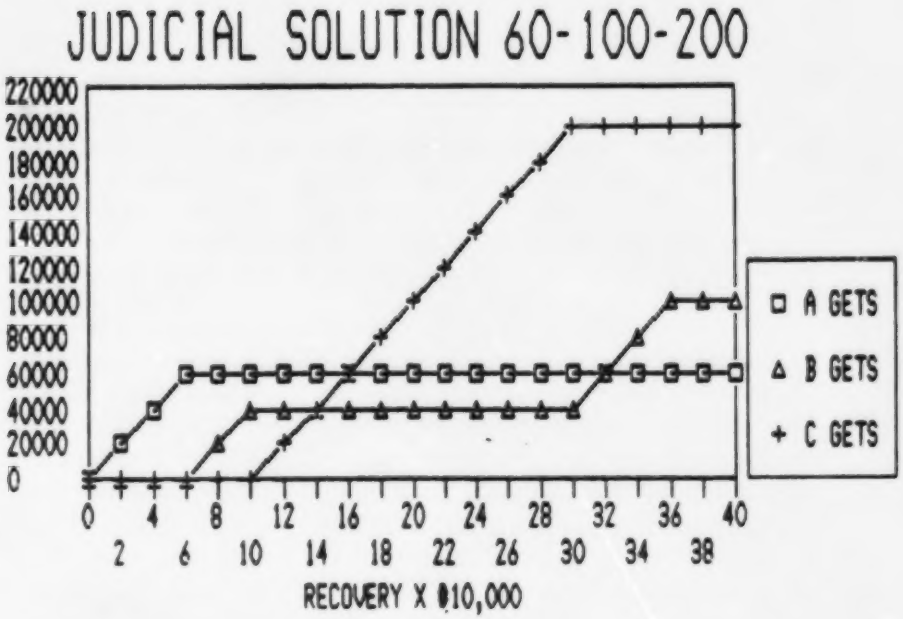
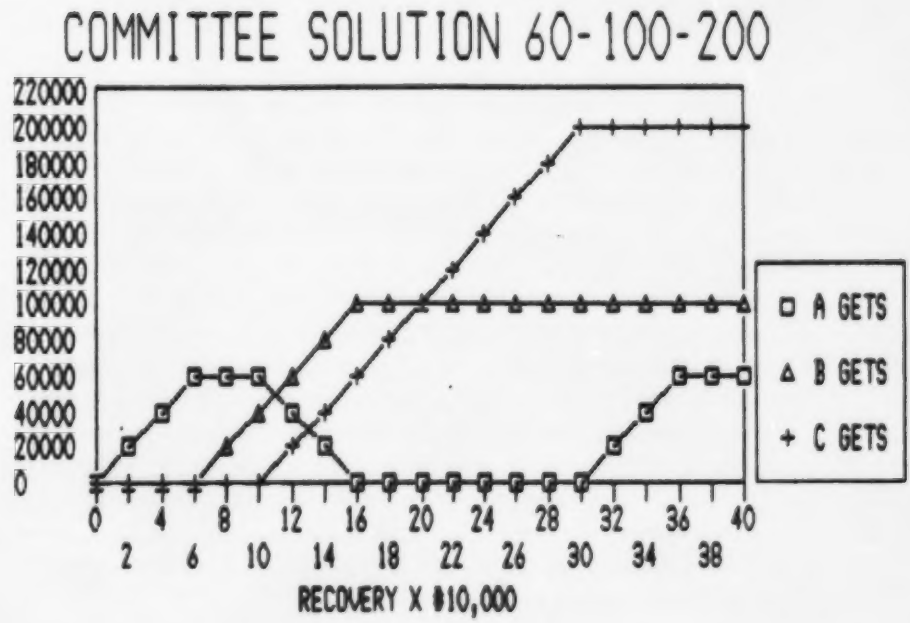


FIGURE 2



APPENDIX D

TRANSITION

When the *Personal Property Security Act* (PPSA) comes into force, the register of corporate mortgages under the *Company Act* will no longer be used. There will, however, be a large number of existing corporate mortgages registered at the Office of the Registrar of Companies. Registration under the *Company Act* is valid in perpetuity. In order to close the registry, there must therefore be a mechanism which provides for the transfer of these registered mortgages into the newly created Personal Property Registry.

Insofar as a currently registered corporate mortgage covers personal property, the PPSA contains provisions which deal with this transition problem. These provisions work in a very simple fashion. Section 77(3) of the Act (reproduced in Appendix B) provides that a mortgage registered under the *Company Act* is deemed to have been registered under the PPSA for five years after the latter Act comes into force. Although registration under the PPSA (unlike under the *Company Act*) is for a specific period of time, section 44(2) allows a registration to be renewed at any time prior to its expiry. If the holder of a corporate mortgage originally registered under the *Company Act* wants the registration of the mortgage to continue beyond the five year grace period, he must renew its registration under the PPSA.

These transition provisions do not apply to floating charges on land. It is for this reason that subsection (10)(c)(iii) of the draft legislation contained in Chapter IV has been framed to authorize the enactment of regulations which apply the transitional rules in the PPSA to floating charges on land. An essential feature of these regulations will be a provision which creates a similar grace period and which deems a renewal with respect to personal property also to be a renewal with respect to the land, provided both are charged in the same instrument. This approach makes considerable practical sense, since nearly all floating charges on land are created in instruments which also cover personal property. As the result of assimilating the transitional mechanism for floating charges on land with that for corporate mortgages on personal property, no extra work is created for either registry staff or the holder of a floating charge.

APPENDIX E

MEMBERS OF THE ADVISORY COMMITTEE ON FLOATING CHARGES ON LAND

Professor T.J. Wuester (Chairman)

T. Bell

B.W.F. Fodchuk

M.H. Gropper

J.P.M. McAvity

The Hon. Mr. Justice B. Macdonald

M.V. Newbury

R.W. Stuart

D.F. Tysoe